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IN THE UNITED STATES BANKRUPTCY COURT  
FOR THE EASTERN DISTRICT OF VIRGINIA  
RICHMOND DIVISION

- - - - - x  
:  
In re: : Chapter 11  
:  
CIRCUIT CITY STORES, INC., : Case No. 08-35653 (KRH)  
et al., :  
:  
Debtors. : Jointly Administered  
- - - - - x

**DEBTORS' OBJECTION TO MOTION OF DIRECTV, INC. FOR RELIEF  
FROM THE AUTOMATIC STAY TO EFFECT SETOFF AND MEMORANDUM  
OF POINTS AND AUTHORITIES IN SUPPORT THEREOF**

The debtors and debtors in possession in the  
above-captioned jointly administered cases (collectively,

"Circuit City" or the "Debtors")<sup>1</sup> hereby submit their objection (the "Objection") to the Motion of DIRECTV, Inc. For Relief From The Automatic Stay To Effect Setoff And Memorandum Of Points And Authorities In Support Thereof (the "Motion"). In support of the Objection, the Debtors respectfully represent:

#### **BACKGROUND**

##### **A. The Bankruptcy Cases.**

1. On November 10, 2008 (the "Petition Date"), the Debtors filed voluntary petitions in this Court for relief under chapter 11 of title 11 of the United States Code (the "Bankruptcy Code").

2. The Debtors continue to manage and operate their businesses as debtors in possession pursuant to Bankruptcy Code sections 1107 and 1108.

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<sup>1</sup> The Debtors and the last four digits of their respective taxpayer identification numbers are as follows: Circuit City Stores, Inc. (3875), Circuit City Stores West Coast, Inc. (0785), InterTAN, Inc. (0875), Ventoux International, Inc. (1838), Circuit City Purchasing Company, LLC (5170), CC Aviation, LLC (0841), CC Distribution Company of Virginia, Inc. (2821), Circuit City Properties, LLC (3353), Kinzer Technology, LLC (2157), Abbott Advertising Agency, Inc. (4659), Patapsco Designs, Inc. (6796), Sky Venture Corp. (0311), Prahs, Inc. (n/a), XSStuff, LLC (9263), Mayland MN, LLC (6116), Courchevel, LLC (n/a), Orbyx Electronics, LLC (3360), and Circuit City Stores PR, LLC (5512). The address for Circuit City Stores West Coast, Inc. is 9250 Sheridan Boulevard, Westminster, Colorado 80031. For all other Debtors, the address is 9950 Mayland Drive, Richmond, Virginia 23233.

3. On November 12, 2008, the Office of the United States Trustee for the Eastern District of Virginia appointed a statutory committee of unsecured creditors (the "Creditors' Committee"). To date, no trustee or examiner has been appointed in these chapter 11 cases.

4. On January 16, 2009, the Court authorized the Debtors, among other things, to conduct going-out-of-business sales at the Debtors' remaining stores pursuant to an agency agreement (the "Agency Agreement") between the Debtors and a joint venture, as agent (the "Agent"). On January 17, 2009, the Agent commenced going-out-of-business sales at the Debtors' remaining stores pursuant to the Agency Agreement.

**B. The Debtors' Agreements with DIRECTV.**

5. Circuit City Stores, Inc. ("Circuit City" or "Debtor") and DIRECTV, Inc. ("DIRECTV") entered into a referral and commission arrangement in 2007. Upon the start of this relationship, they became parties to the Authorized Retailer Agreement [Interim] dated June 1, 2007 (the "June Retailer Agreement"). The parties used this agreement as a temporary measure to memorialize the

terms of their relationship until they finalized a new order fulfillment process, which they anticipated would be complete in October of 2007. June Retailer Agreement Section C.

6. As planned, upon transitioning to the new order fulfillment process, the parties memorialized their relationship to conform to the revised order fulfillment process. They did this through an Authorized Retailer Agreement dated October 23, 2007 (the "October Retailer Agreement", and together with the June Retailer Agreement, the "Retailer Agreements"), which contained essentially the same terms as the June Retailer Agreement.

7. Pursuant to the Retailer Agreements, Circuit City marketed and promoted DIRECTV receivers, service, and programming packages in its stores. Circuit City's main compensation under the Retailer Agreements was commissions. Circuit City received three types of commissions: programming commissions, programming commissions for orders through prospective referral customers, and additional compensation for orders through prospective referral customers.

See October Retailer Agreement Sections 7, 8, 9; June Retailer Agreement Sections 7, 9, 10. Circuit City received these commissions for persuading customers to purchase DIRECTV programming packages, referring prospective customers to DIRECTV, and referring subscribers to the DIRECTV website via a Circuit City website. Id.

8. Circuit City and DIRECTV are also parties to a Master Dealer Agreement ("Dealer Agreement", and, collectively with the Retailer Agreements, "the Agreements") dated April 2005. The Dealer Agreement provides that Circuit City will act as an independent retailer for DIRECTV broadcast satellite service.

See Dealer Agreement, Recitals. Specifically, under the Dealer Agreement, Circuit City purchased hardware from DIRECTV for set prices for Circuit City to sell in its stores. This hardware was primarily DIRECTV Receiver Systems. Circuit City was permitted to sell the receivers in its stores at prices fixed by Circuit City.

**C. Prepetition Transactions Between DIRECTV And Circuit City.**

9. Pursuant to the Dealer Agreement, DIRECTV sold hardware to Circuit City for Circuit City to sell in its stores (the "Hardware Sales"). DIRECTV then invoiced Circuit City for that hardware. DIRECTV claims the Debtors owe \$488,075 for these pre-petition Hardware Sales (the "Hardware Claim"). See Motion ¶ 8; Lorenz Declaration Exhibit 1.

10. Separately, Circuit City promoted DIRECTV programming services to customers in Circuit City stores, pursuant to the June and October Retailer Agreements. Circuit City invoiced DIRECTV for commissions for DIRECTV programming packages that customers activated or purchased through Circuit City stores. Pre-petition, Circuit City requested payments from DIRECTV under the Retailer Agreements for commissions totaling \$405,000, which amount was due and payable by DIRECTV as of the Petition Date and remains outstanding (the "Commission Claim"). See Motion ¶ 9; Eichler Declaration Exhibit 1.

### **SUMMARY OF OBJECTION**

11. By the Motion, DIRECTV asks this Court for relief from the automatic stay to permit DIRECTV to setoff and/or recoup its Hardware Claim against the Debtors' Commission Claim. The Debtors contend that the Motion should be denied on three grounds. First, the Motion is procedurally improper because none of the Agreements has yet been either assumed or rejected and, thus, DIRECTV's request is premature. Second, even if the Motion was procedurally proper, DIRECTV cannot satisfy the standards for relief from the automatic stay and setoff. Third, DIRECTV cannot satisfy the requirements for recoupment. Therefore, the Court should deny the Motion.

### **ARGUMENT**

**I. A MOTION FOR RELIEF FROM THE AUTOMATIC STAY IS A PROCEDURALLY IMPROPER VEHICLE TO ENFORCE CONTRACT RIGHTS.**

12. DIRECTV has asked this Court for relief from the automatic stay to enforce its rights under the Retailer Agreements and Dealer Agreement by permitting setoff. Motion ¶ 4 (requesting "relief from the automatic stay to set off \$405,000"). A motion for

relief from the automatic stay is not the procedurally proper vehicle for DIRECTV to enforce these Agreements. Instead, DIRECTV should have moved to compel assumption or rejection of these contracts.

13. A debtor in possession has until confirmation of a plan to assume or reject an executory contract. 11 U.S.C. § 365(d)(2); In re Wheeling-Pittsburgh Steel Corp., 54 B.R. 385, 388 (Bankr. W.D.Pa. 1985) ("As this language clearly states, the debtor may wait until the plan confirmation date to make its decision to assume or reject an unexpired [executory contract]."). "It is the clear policy of the Bankruptcy Code to provide the debtor with breathing space following the filing of a bankruptcy petition, continuing until the confirmation of a plan, in which to assume or reject an executory contract." In re Dana Corp., 350 B.R. 144, 147 (Bankr. S.D.N.Y. 2006); In re Wheeling-Pittsburgh Steel Corp., 54 B.R. at 388 ("Permitting the debtor to make its decision as late as the plan confirmation date enables the debtor to carefully evaluate the possible benefits and burdens of an [executory contract].").



14. The non-debtor party may not enforce the terms of a contract until the debtor chooses to assume or reject that contract. NLRB v. Bildisco & Bildisco, 465 U.S. 513, 532 (1984); In re Alongi, 272 B.R. 148, 152 (Bankr. D.Md. 2001) (citing In re El Paso Refinery, L.P., 220 B.R. 37, 48 (Bankr. W.D.Tex. 1998)); In re St. Francis Physician Network, Inc., 213 B.R. 710, 714 (Bankr. N.D.Ill. 1997) ("it is settled law that a pre-bankruptcy contract is not enforceable against the debtor until it is assumed, but may be enforced by the debtor even before it is assumed") (emphasis in original).

15. The Debtors have not assumed either the Retailer Agreements or the Dealer Agreement. Thus, because DIRECTV seeks to enforce the Agreements by obtaining an order permitting setoff or recoupment allegedly under the terms of those Agreements (see Motion ¶ 5), a motion for relief from the automatic stay is not the proper procedural means to do so. Instead, DIRECTV must first obtain an order compelling the Debtors to assume or reject the Agreements. See, e.g., In re El Paso Refinery, 220 B.R. at 43 (noting that

motion to compel or reject, not motion for relief from the automatic stay, is the appropriate mechanism to enforce contract rights, even if debtor is not performing contract obligations).

16. Therefore, the Court should deny the Motion because it is procedurally improper. Indeed, until the Debtors assume or reject the Agreements, DIRECTV's request to setoff or recoup the Hardware Claims against the Commission Claim or any other claims the Debtors may hold against DIRECTV is premature. Accordingly, the Motion should be denied without prejudice to DIRECTV seeking similar relief after the Debtors assume or reject the Agreements.

**II. DIRECTV HAS NOT SATISFIED EITHER STANDARD FOR RELIEF FROM THE AUTOMATIC STAY.**

17. DIRECTV cannot establish that it is entitled to relief from the automatic stay under either Bankruptcy Code section 362(d)(1) or 362(d)(2).

**A. DIRECTV Has Not Established Cause To Modify The Automatic Stay Under 362(d)(1).**

18. DIRECTV asserts that it is entitled to relief from the automatic stay under section 362(d)(1) for cause to setoff its Hardware Claim against the

Debtors' Commission Claim. Motion ¶ 27. During the automatic stay, a creditor may not setoff "any debt owing to the debtor that arose before the commencement of the case under this title against any claim against the debtor." 11 U.S.C. 362(a)(7). A court may grant relief from the automatic stay "for cause, including lack of adequate protection of an interest in property of such party in interest." 11 U.S.C. 362(d)(1).

19. In the context of stay relief motion to offset or setoff, cause exists to modify the automatic stay where (1) the moving party establishes a valid right of setoff or offset, (2) neither the debtor nor the estate would be prejudiced by the modification, and (3) the hardship to the plaintiff from continuing the stay outweighs the hardship to the debtor by modifying the stay. See In re Fernstrom Storage & Van Co., 100 B.R. 1017, 1023 (Bankr. N.D.Ill. 1989). The party seeking relief from the stay bears the burden of showing "cause" exists. In re Prop. Techs., Ltd., 263 B.R. 750, 753 (Bankr. E.D.Va. 2001); In re Trius Corp., 47 B.R. 3, 5 (Bankr. D.S.C. 1984).

20. DIRECTV has not met its burden to show cause exists to modify the fundamental protection of the automatic stay, and the Court should deny its Motion.

**(1) DIRECTV should not be permitted to setoff its Hardware Claim against the Debtors' Commission Claim.**

21. DIRECTV has not shown that it has a valid legal or equitable right of setoff.

22. In order for a creditor to employ the right of setoff preserved in section 553, "it must meet four conditions: 1) the creditor must hold a pre-petition claim against the debtor; 2) the creditor must owe a debt to the debtor that arose pre-petition; 3) the obligations are mutual; 4) the obligations are valid and enforceable." In re Vance, 298 B.R. at 267; In re Camellia Food Stores, Inc., 287 B.R. 52, 59 (Bankr. E.D.Va. 1989). DIRECTV bears the burden of proving these elements by a preponderance of the evidence. In re EBW Laser, Inc., No. 07-2004, 2009 WL 116995, at \*2 (Bankr. M.D.N.C. Jan. 15, 2009). DIRECTV cannot do so.

23. Setoff permits parties who owe money to each other to "apply their mutual debts against each other." Citizens Bank of Maryland v. Strumpf, 516 U.S.

16, 18 (1995). Specifically, the requirement of mutuality mandates that the offsetting debts be due from the same parties, in the same capacities. See, e.g., In re Thompson, 182 B.R. at 152; Westinghouse Credit Corp., 278 F.3d at 149. DIRECTV has not met its burden to show the debts are mutual. Thus, setoff does not apply and the Court should deny the Motion.

24. DIRECTV and Circuit City did not act in the same capacities under the Retailer Agreements and Dealer Agreement. Under the Retailer Agreements, Circuit City acted as a commissioned agent that only received payment upon activating DIRECTV programming for a customer. Under the Dealer Agreement, Circuit City purchased hardware from DIRECTV and received payment regardless of whether Circuit City subsequently sold the products to retail customers.

25. As such, Circuit City acted in two different capacities - as a sales agent paid by commission, and as a retail hardware seller. Similarly, DIRECTV acted in two different capacities - as a service and programming provider, and as a seller of hardware.

Thus, the requirement of mutuality is not satisfied, and DIRECTV cannot satisfy a valid right of setoff.

26. Without such a right, there is no cause for this Court to modify the automatic stay. See In re Drexel Burnham Lambert Group Inc., 113 B.R. 830, 838 (Bankr. S.D.N.Y. 1990) (denying relief from automatic stay to exercise setoff rights where creditor could not establish elements of setoff, noting "the courts have uniformly ruled that cause under section 362(d)(1) requires the establishment of a legally sufficient basis for the action sought"). Accordingly, the Court should deny DIRECTV's request to modify the automatic stay under section 362(d)(1) to permit setoff.

**(2) DIRECTV will not be prejudiced by waiting until the Debtors assume or reject the Agreements.**

27. There is no reason to modify the stay at this time because DIRECTV will not suffer any prejudice if the stay is not lifted.

28. DIRECTV concedes that it owes Circuit City over \$400,000. See Motion ¶ 9 ("As of the commencement of Circuit City's bankruptcy case, DIRECTV owed Circuit City \$405,000 (the 'Circuit City Claim') on

account of DIRECTV obligations." ). DIRECTV simply asks that it be allowed to setoff that amount out of an amount that Circuit City owes DIRECTV. However, Circuit City has not instituted an action seeking payment of the receivable and DIRECTV is free to assert offset as a defense, when and if Circuit City does so.

29. At this time, nothing requires the Court to permit DIRECTV to offset, or for the matter to be dealt with prior to the Debtors' decision to assume or reject the DIRECTV Agreements. DIRECTV will not be prejudiced by waiting until the Debtors can review their records to determine how much the Debtor might owe DIRECTV. Therefore, denying this Motion is appropriate and will not prejudice DIRECTV.

**(3) The hardship to Debtors from modifying the stay outweighs the hardship to DIRECTV from continuing the stay.**

30. "The automatic stay is one of the most fundamental debtor protections supplied by the bankruptcy code." In re Thompson, 182 B.R. at 146 (quoting University Med. Ctr. v. Sullivan (In re University Med. Ctr.), 973 F.2d 1065, 1074 (3d Cir. 1992)). "The automatic stay is key to the collective and

preservative nature of bankruptcy proceedings. It protects debtors and creditors alike . . ." In re Drexel Burnham Lambert Group, 113 B.R. at 837. The Debtors should not be denied the protection of the breathing room of the automatic stay to assess the validity and amount of DIRECTV's claims.

31. As noted above, the Debtors still need time to review their records and determine how much DIRECTV might owe the Debtors, and how much the Debtors may owe DIRECTV. If the stay is modified, it would eviscerate the purpose of the automatic stay to provide the Debtors breathing room to permit them time to review claims and ensure ratable distribution to creditors of established claims. In re Drexel Burnham Lambert Group, 113 B.R. at 837. (noting automatic stay protects debtors and creditors by preserving estate property and ensuring distribution pursuant to the plan); In re ABC-NACO, Inc., 294 B.R. 832, 836 n.2 (Bankr. N.D.Ill. 2003) (pointing out that setoff violates normal distribution by effectively granting a "higher priority" to unsecured claims). If the stay continues, DIRECTV will be in the same position it currently is, and thus suffers no



hardship from the stay remaining in place. On the other hand, if the stay is modified, the Debtors will be denied one of the fundamental protections of the Bankruptcy Code and the bankruptcy priority scheme may be disrupted. Because the balance of the equities and hardships favors the Debtors, the Court should deny the Motion.

**B. DIRECTV Has Not Demonstrated That The Debtors Lack Equity To Justify Modifying The Automatic Stay Under 362(d)(2).**

32. Alternatively, DIRECTV asserts that it is entitled to relief from the automatic stay under section 362(d)(2). Motion ¶ 28. It is not.

33. Bankruptcy Code section 362(d)(2) provides that a court may modify the automatic stay:

with respect to a stay of an act against property under subsection (a) of this section if-

(A) the debtors does not have an equity in such property; and

(B) such property is not necessary to an effective reorganization. . .

11 U.S.C. § 362(d)(2).

34. Both conditions (A) and (B) must be satisfied for a court to grant relief from the stay. In

re Prop. Techs., Ltd., 263 B.R. 750, 754 (Bankr. E.D.Va. 2001) (denying relief from stay when movant only was unable to show that debtor lacked equity); Chrysler LLC v. Plastech Engineered Prods. (In re Plastech), 382 B.R. 90, 109 (Bankr. E.D.Mich. 2008) (relief under 362(d) "requires a showing of both elements").

35. Initially, there is a threshold legal question whether Bankruptcy Code section 362(d)(2) applies to a creditor's request to modify the stay to setoff. Setting that aside and assuming arguendo it applies, with respect to element A, DIRECTV bears the burden of proving the Debtors lack equity. 11 U.S.C. 362(g); In re Prop. Techs., 263 B.R. at 753-54 ("plaintiff has the burden or proof on the issue of debtor's lack of equity in the property"). DIRECTV has not met this burden.

36. As demonstrated above, DIRECTV cannot show that it has a legal right to setoff. Therefore, DIRECTV cannot show that the Debtors lack equity in the amounts due from DIRECTV. Indeed, because DIRECTV has not established that the amount due from the Debtors should be applied to offset the amount due to the

Debtors, the Debtors have "equity" -- \$405,000 worth -- in the amount due from DIRECTV. Therefore, DIRECTV has not met its burden.

37. Additionally, DIRECTV does not provide any factual support for its conclusion that the Debtors' lack equity. See Motion ¶ 28 ("In the alternative, DIRECTV is entitled to relief from the stay under 11 U.S.C. § 362(d)(2) because Circuit City has no equity in the DIRECTV Claim to the extent of DIRECTV's right of setoff . . ."). Mere conclusory statements are not sufficient to satisfy the burden of proof. See In re Texaco Inc., 81 B.R. 820, 829 (Bankr. S.D.N.Y. 1988); see also In re Prop. Techs., 263 B.R. at 754 (plaintiff failed to carry burden of showing lack of equity when he did not present any evidence to that effect). Because DIRECTV has not provided any factual support and relies instead on conclusory statements in support of relief under Bankruptcy Code section 361(d)(2), DIRECTV has not met its burden to show Debtors lack equity.

38. Accordingly, DIRECTV's request to terminate or modify the automatic stay should be denied.

**III. DIRECTV MAY NOT PROPERLY RECOUP THE HARDWARE CLAIM  
OUT OF THE COMMISSION IT OWES TO THE DEBTORS.**

39. As an alternative to setoff, DIRECTV contends that it may recoup the Hardware Claim out of the amounts owed to the Debtors for the Commission Claim. Motion ¶ 4 ("DIRECT seeks to recoup or, in the alternative for relief from the automatic stay to set off"). This argument should also be rejected.

40. "Recoupment is the right of the defendant to have the plaintiff's monetary claim reduced by reason of some claim the defendant has against the plaintiff arising out of the very contract giving rise to the plaintiff's claim." First Nat'l Bank of Louisville v. Master Auto Serv. Corp., 693 F.2d 308, 310 n.1 (4th Cir. 1982). For recoupment to apply, a party must demonstrate two elements: (1) the source of the creditor's claim must be a contract, and (2) the debtor's and creditor's claims must arise out of the same contract. In re Vance, 298 B.R. 262, 267 (Bankr. E.D.Va. 2003); Thompson v. Board of Trs. of Fairfax County Police Officers Ret. Sys. (In re Thompson), 182 B.R. 140, 147 (Bankr. E.D.Va. 1995).

41. To meet the second element of the test, the debtor's claim must arise from the "very contract giving rise to" the creditor's claim. First Nat'l Bank, 693 F.2d at 310 n.1. In that regard, the Fourth Circuit looks to whether the claims arise from the "same transaction" analysis. See In re Camellia Food Stores, Inc., 287 B.R. 52, 61 (Bankr. E.D.Va. 1989); see also In re St. Francis Physician Network, 213 B.R. at 716 ("the essential element of recoupment is that it is a demand arising from the same transaction as the debtor's claim"). Thus, under the doctrine of recoupment the division between prepetition and postpetition claims is not relevant; instead, the Court is called upon to determine whether the claims arise out of the same transaction.

42. Consequently, because the doctrine of recoupment allows a creditor to ignore the distinction between pre-filing and post-filing claims, and thereby potentially diminish the recovery of other creditors, courts have generally held that recoupment is a limited doctrine that should be narrowly construed. See, e.g., In re Camellia, 287 B.R. at 61; Westinghouse Credit Corp.

v. D'Urso, 287 F.3d 138, 147 (2d Cir. 2002); In re St. Francis Physician Network, 213 B.R. at 716-17 (noting "[t]he difficulty with recoupment is that it leads to results inconsistent with the bankruptcy code and fundamental bankruptcy policies"). As demonstrated below, DIRECTV may not recoup the Hardware Claim out of the Commission Claim.

43. DIRECTV's debt to Circuit City for the Commission Claim arises out of the Retailer Agreements. By contrast, the Debtors' liability to DIRECTV for the Hardware Claim arises out of the Dealer Agreement and Circuit City's purchase of DIRECTV hardware for retail sale. Therefore, the debts arise out of distinct contracts, and DIRECTV cannot recoup its Hardware Claim out of the Debtors' Commission Claim. In re Camellia, 287 B.R. at 62 ("The acts giving rise to [the recoupment claim] occurred under distinct contracts and did not arise from the same acts").

44. Nor should this Court accept DIRECTV's contention that although the Retailer Agreements and the Dealer Agreement are separate contracts, they still constitute the "same transaction". See Motion ¶ 15.

First, this argument entirely ignores that fact that both of the Retailer Agreements contain an integration clause that expressly states that the agreement is distinct from other agreements. See June Retailer Agreement Section 27.2 ("INTEGRATION. This Interim Agreement replaces any prior agreement, understanding and commitment between the parties regarding Circuit City's appointment and performance as a commissioned retailer/referral contractor for DIRECTV."); October Retailer Agreement Section 24.2 ("ENTIRE AGREEMENT. This Agreement shall be the entire agreement between Circuit City and DIRECTV with regard to the subject matter thereof.")).

45. Furthermore, the material terms of the Retailer Agreements and the Dealer Agreement are not the same, which indicates the parties did not intend them to be integrated. In re Vance, 298 B.R. at 269 (finding that same material terms in separate agreements indicated that the agreements were integrated).

46. Finally, the Dealer Agreement was made over two years before the Retailer Agreements, further

indicating that the parties did not view these as an integrated transaction.

47. Thus, this is not a case where "both debts [] arise out of a single integrated transaction so that it would be inequitable for the debtor to enjoy the benefits of that transaction without also meeting its obligation." University Med. Ctr. v. Sullivan (In re University Med. Ctr.), 973 F.2d 1065, 1081 (3d Cir. 1992). Therefore, the doctrine of recoupment simply does not apply to DIRECTV's Hardware Claim because DIRECTV cannot meet the second element of the recoupment test. Consequently, the Court should not grant the Motion on this alternative basis.



**CONCLUSION**

WHEREFORE, the Debtors respectfully request that the Court enter an order (i) denying the relief requested in the Motion, and (ii) granting the Debtors such other and further relief as is just and proper.

Dated: February 26, 2009

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